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FISCAL IMPACT STATEMENT

LS 7126 **NOTE PREPARED:** Jan 5, 2004
BILL NUMBER: SB 357 **BILL AMENDED:**

SUBJECT: Tax Incentives for Economic Development.

FIRST AUTHOR: Sen. Ford **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X **GENERAL** **IMPACT:** State & Local
X **DEDICATED**
FEDERAL

Summary of Legislation: *Indiana Endangered Industries:* The bill provides for coordinating Indiana rules that affect Indiana endangered industries with national policies.

Personal Property Assessments: The bill eliminates the 30% floor on the assessed valuation of personal property.

R&D Sales Tax Exemption: The bill exempts purchases of tangible personal property directly used in research and development from the Sales Tax.

Corporate Income Tax Apportionment Formula: It provides that, for purposes of the Indiana Adjusted Gross Income Tax, business income is apportioned based on the sales factor. The bill also eliminates the property factor and payroll factor that are currently also used in apportioning income.

Capital Investment Tax Credit: The bill expands the Capital Investment Tax Credit to apply statewide. It increases the credit from 14% to 30%.

Certified Job Skills Training Program Employer Credit: This bill provides an employer with at least 250 full-time employees a state tax liability credit equal to 50% of expenditures made for job skills training programs on behalf of its employees.

Effective Date: Upon passage; July 1, 2004; January 1, 2005.

Explanation of State Expenditures: *Indiana Endangered Industries:* This bill could increase the administrative burden of an agency with rulemaking authority insofar as it will require the agency to modify or suspend the application of certain rules on industries that meet certain requirements and have been recognized as a qualifying Indiana endangered industry by the General Assembly and the Lieutenant Governor. The bill's impact on state agencies is unknown and will be contingent upon the number of industries that qualify as an Indiana endangered industry and the number and types of rules that are affected.

Personal Property Assessments: The state pays Property Tax Replacement Credits (PTRC) in the amount of 60% of school general fund levies attributable to all property and 20% of the portion of all operating levies (including the remaining 40% of the school GF levy) that are attributable to real property and nonbusiness personal property. Homestead Credits are paid by the state in the amount of 20% of the net property tax for operating funds attributable to owner-occupied residences.

The tax shifts from business personal property to other property in the bill would cause the state's expense for regular PTRC and Homestead Credits to increase. PTRC and Homestead Credits are paid from the Property Tax Replacement Fund, which is annually supplemented by the state General Fund. Therefore, any additional PTRC or Homestead Credit payments would ultimately come from the state General Fund. The additional state expense is estimated at $4.6 M in FY 2006 (partial year) and $13.9 M in FY 2007. This amount will grow by about 5% per year.

Department of State Revenue (DOR): The DOR would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate the income tax changes made by this bill. These expenses presumably could be absorbed given the DOR's existing budget and resources.

Department of Workforce Development (DWD): The certification of the job skills training programs could increase expenditures for the DWD, contingent on the number of existing and new programs that could potentially be certified. The bill also requires the DWD to establish an audit program to verify the eligibility of taxpayers to receive the Certified Job Skills Training Program Employer Credit. The DWD should be able to meet these demands given its current budget and resources. The December 3, 2003, state staffing table indicates that the DWD has 109 vacant full-time positions.

Indiana Department of Commerce (IDOC): The IDOC would incur some administrative expenses due to the expansion of the Capital Investment Tax Credit. Upon request of a taxpayer, the IDOC must review investment by a business to determine if it qualifies for the tax credit. The IDOC should be able to meet these demands given its current budget and resources. The December 3, 2003, state staffing table indicates that the IDOC has 32 vacant full-time positions, including regional office positions.

Explanation of State Revenues: *Personal Property Assessments:* The state levies a tax rate for State Fair and State Forestry. Any reduction in the assessed value base will reduce the property tax revenue for these two funds. The annual revenue reduction under this proposal is estimated at about $32,000 in FY 2006 and $96,000 in years following.

R&D Sales Tax Exemption: The bill exempts certain research and development (R&D) equipment sales from the state's Sales Tax beginning July 1, 2004. The exemption is estimated to reduce Sales Tax revenue by $23 M to $57 M in FY 2005, and by approximately $26 M to $64 M in FY 2006.

Sales Tax revenue is deposited in the: Property Tax Replacement Fund (50%), the state General Fund (49.192%), the Public Mass Transportation Fund (0.635%), the Commuter Rail Service Fund (0.14%), and the Industrial Rail Service Fund (0.033%).

The Sales Tax estimate above is based on data obtained from the National Science Foundation (NSF) that describes the total value of industrial research and development performed in Indiana through CY 2000. Based on past R&D expenditures and adjusting for growth, it was estimated that in FY 2005, Indiana firms will expend a total of approximately $2,984 M on R&D in Indiana. In FY 2006, these expenditures are expected to increase to $3,047 M. Using NSF information on how R&D funds are spent, it was estimated that approximately 14% to 35% of Indiana R&D expenditures would be subject to the state's 6% Sales Tax.

Corporate Income Tax Apportionment Formula: The proposed change in the apportionment formula is likely to decrease Indiana Corporate Income Tax revenues. The estimation of the magnitude of the decrease in revenues is under review.

Background: The apportionment formula is used to determine Indiana Adjusted Gross Income for corporations whose income is derived from sources both within and outside Indiana. Currently, a three-factor apportionment formula is used to determine Indiana Adjusted Gross Income. The formula includes property, payroll, and sales (also called receipts) to allocate business income to the state. The sales factor is double weighted. The current formula is shown below.

$$\left[\frac{Indiana\ Property}{Total\ Property} + \frac{Indiana\ Payroll}{Total\ Payroll} + 2*\left(\frac{Indiana\ Sales}{Total\ Sales}\right)\right] \div 4$$

The bill would eliminate the property and payroll factors in the apportionment formula and the double weight of the sales factor. A corporation's adjusted gross income would be determined by a single-factor formula which measures Indiana sales as a proportion of total sales in the United States. The new formula is shown below.

$$\frac{Indiana\ Sales}{Total\ Sales}$$

Corporate income taxes are distributed to the General Fund and the Property Tax Replacement Fund.

Capital Investment Tax Credit: The bill extends the nonrefundable Capital Investment Tax Credit to qualified capital investment throughout the state. It also eliminates the existing minimum project cost requirement of $75 M. Under current statute, the credit is limited to qualified capital investment that is part of a project in Shelby County with a total cost of at least $75 M. The bill also increases the credit from 14% of the qualified investment to 30% of the qualified investment. The current credit is effectively limited to one company. Thus, the bill significantly expands the pool of potential investment for which the tax credit may be claimed and provides a substantial increase in the credit percentage. These changes could potentially lead to a substantial revenue loss to the state from the credit beginning in the second half of FY 2005 or in FY 2006.

Under current law unchanged by the bill, capital investment that qualifies for the credit includes: (1) the purchase of new manufacturing or production equipment; (2) the purchase of new computers and related equipment; (3) costs associated with the modernization of existing manufacturing facilities; (4) on-site infrastructure improvements; (5) the construction of new manufacturing facilities; (6) costs associated with retooling existing machinery and equipment; and (7) costs associated with the construction of special purpose buildings and foundations for use in the computer, software, biological sciences, or telecommunications industry. This investment must be certified by the Indiana Department of Commerce as being eligible for the credit. Unused credits may be carried forward by a taxpayer for up to three years. The bill requires that items for which the tax credit was granted must be fully installed or completed within 5 years of the date on which the IDOC informs the DOR that the taxpayer is entitled to the tax credit. If not, the "clawback" provision in the bill provides that the DOR may require the taxpayer to repay the amount of tax liability offset by the tax credit, plus interest.

Since the bill is effective beginning in tax year 2005, the fiscal impact could potentially begin in FY 2005 if taxpayers adjust their quarterly estimated payments. The credit may be taken against a taxpayer's Adjusted Gross Income (AGI) Tax, Insurance Premium Tax, or Financial Institutions Tax liability. Revenue from the AGI Tax on corporations, the Insurance Premiums Tax, and the Financial Institutions Tax is distributed to the state General Fund. The revenue from the AGI Tax on individuals is deposited in the state General Fund (86%) and the Property Tax Replacement Fund (14%). Since the tax credit is effective beginning in tax year 2005, the fiscal impact could begin in FY 2006 contingent on internship program certification.

Certified Job Skills Training Program Employer Credit: The bill establishes a tax credit for costs incurred by certain employers for expenses relating to student-trainee placements from certified job skills training programs. This credit could potentially reduce revenue from the Adjusted Gross Income (AGI) Tax, the Insurance Premiums Tax, and the Financial Institutions Tax by an indeterminable amount. However, the fiscal impact would be contingent upon a number of factors, including employer utilization, student interest, and current and future capacity of higher education institutions to operate certified job skills training programs. The fiscal impact could begin in FY 2006 depending upon how quickly existing and new job skills training programs can be certified.

Under the bill, employers with more than 250 full-time employees are entitled to a nonrefundable tax credit against the AGI Tax, Insurance Premiums Tax, or the Financial Institutions Tax for expenses relating to the employment of higher education students participating in a certified job skills training program. The student-interns must be enrolled on at least a part-time basis at the institution of higher education. The job skills training program must be operated by the institution and certified in accordance with the bill by the Department of Workforce Development. The tax credit is equal to 50% of expenses incurred by the employer in providing training to the student trainee.

The credit is not refundable, but may be carried forward to subsequent years. The credit can not be carried back. If an employer is a pass through entity and does not have a tax liability, the credit could be taken by shareholders, partners, or members of the pass through entity in proportion to their distributive income from the pass through entity. The bill provides that training expenses paid by grants from certain state funds are ineligible for the tax credit. (The state funds are the Training 2000 Fund, the Indiana Strategic Development Fund, the Counter-Cyclical Revenue and Economic Stabilization Fund, the Employment and Training Services Administration Fund, the Skills 2016 Training Fund, and the Special Employment and Training Services Fund.) Revenue from the AGI Tax on corporations, the Insurance Premiums Tax, and the Financial Institutions Tax is distributed to the state General Fund. The revenue from the AGI Tax on individuals is deposited in the state General Fund (86%) and the Property Tax Replacement Fund (14%). Since the tax credit is effective beginning in tax year 2005, the fiscal impact could begin in FY 2006 contingent on internship program certification.

Explanation of Local Expenditures:

Explanation of Local Revenues: *Personal Property Assessments:* Under current regulations, the total value of a taxpayer's depreciable property located in the same tax taxing district must be at least 30% of the total cost of the property. This is known as the 30% valuation floor. This bill would remove the floor beginning with March 1, 2005, assessments for property taxes paid in CY 2006.

The removal of the floor would reduce the assessed value of personal property which would shift part of the tax burden from personal property taxpayers to all property taxpayers. The tax shift is estimated at about $103 M in CY 2006 and would grow at about 5% per year. This amount is the net reduction for personal property taxpayers and the gross increase for other taxpayers. The net increase for other taxpayers is estimated at about $90 M per year.

State Agencies Affected: Department of Local Government Finance; Department of State Revenue; Lieutenant Governor; Legislative Services Agency; Department of Workforce Development; Indiana Department of Commerce; Higher Education Institutions; Department of Education; Agencies with rulemaking authority.

Local Agencies Affected:

Information Sources: Personal Property Return Data; Local Government Database.

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